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SUBJECT: THE EU'S "CASPIAN DEVELOPMENT CORPORATION" PROPOSAL

REF: A. BRUSSELS 1761  
    1B. BRUSSELS 1697  
    1C. BRUSSELS 1532  
    1D. BRUSSELS 952

11. (SBU) Summary. On 14 November, and in a series of earlier meetings, DG-TREN Officials explained the concept of the "Caspian Development Corporation" (CDC) to Econ Offices.

As proposed by the EU Commission, the CDC would have the mandate to aggregate gas demand from European buyers and present a single large offer to Turkmenistan. The CDC is intended as a vehicle that would help accelerate gas development in the Caspian region, present a credible single European client to Turkmenistan and other countries to whom they could conveniently and securely sell significant volumes of gas, and who as a counterparty would have the greatest credit worthiness and ability to promote gas development and related transport infrastructure. In justifying the CDC approach, the Commission argues that the European energy market model, where individual companies buy and sell gas using a tightly-regulated network for transport, has not delivered expected results when attempted to be extended to the Caspian region. If desired, DG-TREN officials offered to travel to the U.S. to do a "road show" explaining the CDC concept. End Summary.

The CDC Concept

12. (SBU) On November 14 (and in a series of earlier meetings) DG-TREN Officials explained the concept of the "Caspian Development Corporation" (CDC) to Econ Officers. As proposed by the EU Commission, the CDC would have the mandate to aggregate gas demand from European buyers and serve as a single, substantial client for Turkmen gas. The actual structure of the CDC could be a consortium of companies or something along the lines of a merchant bank that would be contracted by companies to provide the aggregation and negotiation services and a clearing and settlement mechanism.

The CDC is intended as a vehicle that would help accelerate gas development in the Caspian region, present a credible single European client to Turkmenistan and other countries to whom they could conveniently and securely sell significant volumes of gas, and who as a counterparty would have the greatest credit worthiness and ability to promote gas development and related transport infrastructure.

13. (SBU) DG-TREN officials stressed that the CDC is intended solely for Turkmenistan and is not intended to be used in countries, such as Azerbaijan, where open market mechanisms are already in place. (Note: Other Commission pronouncements have indicated that while the focus of the CDC would be on Caspian gas, it could also purchase gas from the Middle East and Russia. End note.) The Commission intends

for the CDC to be simple and transitional to overcome perceived market risk and a fear of retaliation. Centered on Baku as a collection point for gas from beyond the Caspian, from Central Asia and the Middle East, the CDC would aim to bring in new gas supplies of between 60 and 120 billion cubic meters of gas per annum for the EU. The Commission believes that that type of financially guaranteed commitment will give comfort to Central Asian gas suppliers to open up new investments and issue new licenses. Likewise, it believes the prospect of such volumes would help alleviate Turkey's energy security concerns, allowing the Azeris to commit more gas Nabucco and/or TGI.

¶4. (SBU) DG-TREN officials indicated that as currently conceived CDC would not have exclusivity over gas purchasing from the region and CDC would be independent from the Southern Corridor pipeline projects -- though it could build new infrastructure where needed. Along these lines, DG-TREN officials believe the CDC could finance or at the least enable the building of a trans-Caspian gas pipeline from Turkmenistan to Azerbaijan. DG-TREN officials see the CDC as a purely private sector endeavor. As such the only action required by the EU would be relaxing completion rules to allow volume aggregation. He went on to say that the CDC would not have exclusive market rights and would have to have a third-party access system.

¶5. (SBU) The CDC is mentioned as part of the Commission Communication on the 2nd Strategic Energy Review (REF A). The Communication does not spell out details, but simply states: "The feasibility of a block purchasing mechanism for Caspian gas ("Caspian Development Corporation") will be

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explored, in full respect of competition and other EU rules."

The Communication also calls on the Council and Parliament to welcome "the Commission's determination to ensure the development of a Southern gas corridor and encourage the Commission and the Community financial institutions to collaborate closely in exploring the feasibility of block purchasing mechanism ("Caspian Development Corporation")."

The Commission's Justification for the CDC

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¶6. (SBU) In justifying the CDC approach, the Commission argues that the European energy market model, where individual companies buy and sell gas using a tightly-regulated network for transport, has not delivered expected results in attempts to access Caspian markets. Caspian gas producers focus on the strategic and commercial value of gas trade rather than the implementation of Europe's energy market model. European gas purchasers, including some of the biggest gas companies in the world, have not signed import contracts and are not expected to take the lead in sponsoring Caspian gas development. This reportedly stems largely from concerns about their gas contracts with Gazprom and/or investments in Russia.

¶7. (SBU) These factors have led to the Commission to conclude that it must lead a coordinated approach underwritten by the EU and the European Investment Bank (EIB), along with other multilateral institutions, in order to successfully engage the Caspian producers and European gas companies. One possible role for the EIB is the facilitation of gas purchases directly and/or through participation in joint purchasing through the CDC. Another is the provision of financing and/or guarantees for gas development in the Caspian and related transport infrastructure in the Caspian, South East Europe and the EU. The Commission views Turkmenistan as a special case and one that requires a novel approach if it is to lock it in as a supplier for Nabucco.

World Bank Study

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¶8. (SBU) The Commission has suggested to Turkey that it request a World Bank feasibility study on this concept. The

study itself would be funded by the EU probably through the EIB, not the World Bank, with Turkey as the beneficiary. DG-TREN officials said the initial reaction from the World Bank indicates that they would probably recommend a merchant bank/service contract model rather than a consortium of companies as originally envisaged by the Commission. Under this model a bank or other financial company would act as an aggregator for gas purchase requests from European and Turkish buyers and then would present a single large offer to buy gas to Turkmenistan.

¶19. (SBU) The objectives of the World Bank Study would be to:

-- Examine options to better coordinate Europe's efforts to promote gas production and infrastructure development and coordinate gas purchases including the creation of the Caspian Development Corporation (CDC); and

-- Assuming the CDC approach proceeds, design the concept, structure, method of composition and financing of the CDC, along with the regulatory, legislative and contractual arrangements guiding its relationships both on the buy as well as sell sides.

¶10. (SBU) DG-TREN officials said the Commission would work with the European Investment Bank to finance the World Bank study. The terms of reference for the World Bank study have been shared with Turkey, but not yet with the EU Member States. At this point, the ball appears to be in Turkey's court, and Turkey has not yet made the decision on whether to proceed. One concern is that going the study route would require a year or more before any solution is implemented. DG-TREN officials indicated that U.S. support for the CDC concept would be very helpful, especially with the World Bank and Turkey. If desired, DG-TREN officials offered to travel to the U.S. to do a "road show" explaining the CDC concept.

Comment

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¶11. (SBU) One of the issues that has always swirled around the Caspian/Central Asia gas pipeline concept is the need for sufficient concentrated demand from Europe - this is one reason why the USG has encouraged EU market liberalization.

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The CDC is the Commission's attempt to address the obstacles to moving Turkmen gas west. At this point the CDC project is still just a concept, not a fait accompli. The Commission is looking for a way to deal with what it perceives as the obstacles to moving Turkmen gas west. In going out for a World Bank sponsored study it is opening up the door for other suggestions and a judgment on whether or not this idea should move beyond the proposal stage.

¶12. (SBU) From the competition perspective, the CDC will either have to fully comply with EU competition regulations, or be granted a derogation. Having the Commission champion the CDC would seem a prelude to a derogation. Such a derogation would likely be decided on by DG-TREN (who would champion CDC), but would also require buy-in from DG-COMP. The derogation would most likely be for a fixed period of time. This fits with the Commission idea that the CDC would be the first step towards gas imports from Turkmenistan, but the goal would be to eventually move to a more open competitive model over time.

¶13. (SBU) We see a number of potential benefits to the CDC approach:

-- The CDC could provide the comfort factor Turkmenistan needs to commit to shipping gas west to Europe, provide the Turkmen with another outlet for their gas and lessen their dependence on Russia, and would meet the Turkmen's requirement to sell gas at its border.

-- The CDC could succeed in getting Turkey to back away from

its demand for a 15 percent off-take of any gas transiting Turkey.

-- The CDC could set a useful precedent for the EU pooling its negotiating leverage, and provide a potential partner for the European Investment Bank (EIB) in developing a risk-mitigation mechanism for latter stages of Nabucco.

-- By encouraging upstream development in Turkmenistan, the CDC could benefit U.S. companies seeking to invest in Turkmenistan's gas sector.

¶14. (SBU) We nonetheless also see a number of potential disadvantages to the CDC approach:

-- The CDC idea appears to be counter to the free market messages we have been passing to Turkmenistan and other Caspian states.

-- This approach could encourage the belief among the Turkmen, Azerbaijanis, Turks and the Europeans that only government entities can manage the energy business.

-- This approach could undermine our efforts to advocate on behalf of Chevron, ConocoPhillips, ExxonMobil, and others to allow the private sector to develop Turkmenistan's gas resources and deliver them to market.

-- While initially conceived for Turkmenistan, the concept could be extended to other countries and sources better addressed with a market based approach.

¶15. (SBU) From our optic, the pros of opening up the Southern Corridor, strengthening ties between Europe and Turkey, and decreasing Turkmenistan's dependence on Russia by giving it a western outlet for its gas appear to outweigh the cons. Nevertheless, strong support or for that matter strong opposition for the CDC concept is probably not warranted at this point. If the World Bank Study goes forward, the recommendations it produces may differ greatly from what is currently proposed by the Commission. It will also be important to observe the reactions from Turkmenistan, Azerbaijan, Turkey, and the EU to see if the CDC could actually accomplish the goal of bringing Turkmen gas west to Europe.

Silverberg

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